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CHOICE OF LAW IN CONTRACT ACTIONS INVOLVING FOREIGN NATIONALS

T. L. TOLAN, JR.*

Intensive study of the conflict of laws requires the soul of a philosopher. Few of us are so equipped. Hence we sometimes resort to pat answers (often disguised in Latin); or, if we dig deeper in the cases, we are inclined to despair. Practicing lawyers have little difficulty in finding "the answer" to many legal problems. It takes either courage or foolhardiness or both to give a firm opinion on what law governs the interpretation of a contract between residents of two states, negotiated, say, by mail, and calling for performance in one or another—or a third—of the states.

Another logical problem is added if suit is in a Federal court. But since the *Erie*¹ case, the Supreme Court of the United States has been loyal to the logic of that decision. Logic has seemed to compel its extension to conflict of laws rules applied by state courts. And in the *Klaxon*² case the Court confirmed this logic and held that a Federal court in a diversity case must seek the result of the conflict of law rules which would be applied if suit had been brought in the local state court.

But *Erie* and *Klaxon* concerned suits between citizens of different states of the United States. Does their rule apply if one of the parties is a citizen of a foreign nation? Some courts have held that it does³—but without discussion and presumably without argument of the point by counsel. The Supreme Court has never considered the question. I suggest that application of *Erie* to actions involving contracts in which a foreign national is a party may well be a mistake; that in these cases, at least, Federal courts should fashion their own body of conflict of laws in this situation; and—a more far-reaching step, of course—that that body of law should bind the state courts as well.

I may as well admit at the outset that I have become convinced by the arguments in favor of these suggestions. What follows is a brief in their support rather than either a balanced or a scholarly discussion

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¹ *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938). I shall not attempt a bibliography of even recent comments on this case, which is now being subjected to academic attack. See, for example, Keeffe, Gilhooley, Baily and Day, "*Weary Erie*", 34 Cornell L. Q. 494 (1949).

² *Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487 (1941).

³ See, for one of many examples, *Plotnick v. Pennsylvania Smelting & Refining Co.*, 194 F.2d 859 (3rd Cir. 1952).

of alternative possibilities. One reason for this approach is that the opposing arguments seem (to me) both obvious and faulty. It is easy to argue that a diversity case is a diversity case, whether the diverse citizens are of different United States or different nations; that the Rules of Decisions Act⁴ does not differentiate between the two situations; that a Federal rule as opposed to application of State law encourages forum-shopping, the vice *Erie* was supposed to halt; and that one encourages diversity jurisdiction by fashioning a Federal rule here, and modern thinking encourages the contraction of that jurisdiction when Federal courts are no longer assumed to be always more just than state courts. There are other arguments, including the "right" of the separate sovereign states in our federal system to make their own rules. The reader may judge whether these "obvious" arguments are, in fact, faulty, as I contend—or are at least outweighed by other considerations—after reading what is set out below.

I.

THEORETICAL BASIS OF AN ARGUMENT THAT FEDERAL LAW SHOULD GOVERN

Erie and *Klaxon* were decided in the setting of that part of Article III, Section 2 of the Constitution which states:

The judicial power shall extend to . . . controversies . . . between citizens of different states. . . .

Neither the *Klaxon* case nor any other case in the Supreme Court of the United States which I have found holds that the law of the state in which the Federal court is sitting must or should be applied when the action involves a controversy "between a state, or the citizens thereof, and foreign States, citizens or subjects", under the last clause of the first paragraph of Article III, Section 2, of the United States Constitution. In fact, the indications are that Federal rather than state conflicts rules should be applied to these cases, for they involve the international relationships of the United States Government and the relations between its citizens and those of foreign countries. Traditionally, of course, these have been matters for the Congress of the United States, and the Executive and Senate under the treaty power, rather than a matter for the individual states. Federal control over the international relations of U.S. citizens and their rights as against foreign powers and their subjects is too firmly embedded in the history of our country to require restatement here. It was a central purpose for the adoption of the Constitution. The Supreme Court made this apparent in 1937 when it declared, with reference to an international agreement:

[C]omplete power over international affairs is in the national government and is not and cannot be subject to any curtailment or interference on the part of the several states. . . . In respect

⁴ 62 Stat. 944 (1948), 28 U.S.C. §1652 (1959).

of all international negotiations and compacts, *and in respect of our foreign relations generally*, state lines disappear. As to such purposes the State of New York does not exist.⁵ (Emphasis added).

Logic would suggest that a uniform system of law enforced by Federal courts should also be applied in suits involving U.S. citizens and the subjects of a foreign king or other foreign sovereign. In a 1947 case involving the rights of the United States to recover the sums paid to and on behalf of its soldiers because of the torts of others, the Supreme Court stated the reasons why it *may* be held that *Erie* should not apply to suits by foreign nationals:

The great object of the *Erie* case was to secure in the federal courts, in diversity cases, the application of the same substantive law as would control if the suit were brought in the courts of the state where the federal court sits. It was the so-called 'federal common law' utilized as a substitute for state power, to create and enforce legal relationships in the area set apart in our scheme for state rather than for federal control, that the *Erie* decision threw out. Its object and effect were thus to bring federal judicial power under subjection to state authority in matters essentially of local interest and state control.

Conversely there was no purpose or effect for broadening state power over matters essentially of federal character or for determining whether issues are of that nature. The diversity jurisdiction had not created special problems of that sort. Accordingly the *Erie* decision, which related only to the law to be applied in exercise of that jurisdiction, had no effect, and was intended to have none, to bring within the governance of state law matters exclusively federal, because made so by constitutional or valid congressional command, *or other so vitally affecting interests, Powers and relations of the Federal Government as to require uniform national disposition rather than diversified state rulings*. Cf. *Clearfield Trust Co. v. United States*, 318 U.S. at 366-368. Hence, although federal judicial power to deal with common-law problems was cut down in the realm of liability or its absence governable by state law, that power remained unimpaired for dealing independently, wherever necessary or appropriate, with essentially federal matters, even though Congress has not acted affirmatively about the specific question.⁶ (Emphasis added).

Justice Jackson saw fit to observe, by way of footnote, in a 1942 concurring opinion:

. . . [T]he common-law doctrines of conflict of laws worked out in a unitary system to deal with conflicts between domestic and truly foreign law may not apply unmodified in conflicts be-

⁵ *United States v. Belmont*, 301 U.S. 324, 331 (1937).

⁶ *United States v. Standard Oil Co.*, 332 U.S. 301, 307 (1947).

tween the laws of states within our federal system which are affected by the full faith and credit or other relevant clause of the Constitution.⁷

The *Erie* doctrine has been held inapplicable in other cases not involving diversity, and arising under other clauses of Article III—bankruptcy⁸ and U.S. Government obligations.⁹ Perhaps the most notable recent example of the application of Federal law to contracts which had previously been considered to be governed largely by state law was the decision of the Supreme Court of the United States in *Lincoln Mills*.¹⁰ That case decided that the section in the Taft-Hartley Act which appeared merely to give Federal courts jurisdiction of the parties in suits for violations of labor contracts, had the effect of converting all collective bargaining contracts (in industries affecting commerce) into *Federal* contracts, requiring the application of Federal rather than state law, and calling for the application of “judicial inventiveness”¹² in applying Federal rules of interpretation and decision. One commentator has described this decision as a “chink in the armor” of *Erie*.¹³

Converting what has always been understood to be a State matter into Federal subject—by whatever theoretical gymnastics—*could* be a prelude to a holding that when foreign nationals are involved, a uniform Federal rule should be applied rather than a state rule. The suggestion of a leading scholar in the field of conflict of laws, made in 1941, has not been followed, but it has not authoritatively been rejected either. Professor Cheatham argued that the *Erie* rule should not be followed when a foreign national is involved:

For in all aspects of foreign relations, it is natural that the agency of the central government should be dominant. It would seem natural for the federal rule choosing between the law of Illinois and the law of France, or between the law of France and the law of Germany, to be binding on the state courts rather than the reverse.¹⁴

⁷ *D'Oench, Duhme & Co. v. Federal Deposit Insurance Corp.*, 315 U.S. 447, 472 at n. 10 (1942).

⁸ *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156 (1946).

⁹ *Clearfield Trust Co. v. United States*, 318 U.S. 363 (1943).

¹⁰ *Textile Workers Union v. Lincoln Mills*, 353 U.S. 448 (1957).

¹¹ Section 301 of the Labor Management Relations Act of 1947, 61 Stat. 156 (1947), 29 U.S.C. §185 (1958).

¹² *Textile Workers Union v. Lincoln Mills*, *supra* note 10 at 457.

¹³ Kauper, “Supreme Court: Trends in Constitutional Interpretation”, 24 F.R.D. 155, 164 (1959). Of course the bankruptcy, admiralty, United States Government obligation and even collective bargaining contract cases may be dismissed as inapplicable here, because they involve *federal* questions, not diversity cases. The collective bargaining cases, for example, are based upon a statute which specifically eliminates the requirement of diverse citizenship.

¹⁴ Cheatham, *Sources of Rules for Conflict of Laws*, 89 U. Pa. L. Rev. 430, 447, (1941).

Further, a kind of federal pre-emption argument may be available, based upon the treaty power. Many treaties pick the law which shall be applied, some on the basis of contract and others by direct reference—naming the law of the country which is to be applied.¹⁵ Many treaties are so stated that they are of no real help to the practitioner—for example the statement in the 1852 Treaty between the United States and Argentina to the effect that the contract between nationals of the two countries is “subject to general laws and usages of the two countries.”¹⁶ There surely can be little question that if a treaty does in fact state the rule of conflicts to be applied, it governs; here is certainly an appropriate subject on which to exercise the treaty power. In view of the numerous treaties on this general subject, and the need for a national rule noted below, can it not be argued that the very treaty power given to the Executive and the Senate by the Constitution in effect pre-empts the field *even though a particular treaty may not cover the case at bar*? One analogy for such a holding is the dichotomy set out in the *Cooley* case,¹⁷ and followed ever since, with respect to interstate commerce: States may not act even though Congress has not acted in those areas which are deemed *exclusively* Federal in nature, since a uniform national rule is necessary.

II.

PRACTICAL REASONS FOR THE APPLICATION OF THE FEDERAL RULE

One of the principal justifications for the *Erie* rule was that it discouraged forum-shopping: when a federal court became “just another court of a state,”¹⁸ the person who will bring suit in that state will not get a different result based upon different rules of substantive law prevailing in the state and federal courts in the jurisdiction in question. Quite an argument can be made that this reason for *Erie* should lead to a uniform Federal rule, rather than application of the *Erie* rule, when a foreign national is involved in a contract case. Ordinarily the foreign national has his contract with a corporation which has offices in a number of places in the United States; if he can choose in which state to bring his action on the basis of what substantive rules of choice of law¹⁹ will be applied among the various states in which he may bring

¹⁵ Bayitch, “Conflict Law in United States Treaties”. This book was first published in the Miami Law Quarterly, to which the following citations refer.

¹⁶ Bayitch, *supra*, 8 Miami L. Q. at 512. *Lex locus delicti* is stated to apply in the 1938 treaty between the United States and Liberia, 8 Miami L. Q. at 509 & n. 37. A relatively rare provision is that transfer of property is to be made “under the provisions of the laws of the jurisdiction in which the property is found.” United States - Sweden treaty of 1910, Article XIV, 4, cited at 9 Miami L. Q. at 126-7. See also the treaty between the United States and Germany discussed in *Clark v. Allen*, 331 U.S. 503 (1947).

¹⁷ *Cooley v. Port Wardens*, 12 How. 299 (1851).

¹⁸ *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945).

¹⁹ I recognize that many of the same arguments in this paper apply with equal

suit, "forum-shopping" is encouraged rather than discouraged by the *Erie* rule.

Probably the most potent policy reason in favor of a Federal rule is the damage which might be done by a parochial state court to the foreign relations of the United States. Federal judges are at least presumed to have more knowledge about these implications. For example, suppose there is litigation between an American and a prominent Arabian national involving the terms of a contract for the sale of Arabian oil. It may be that the United States Department of State would want to appear as *amicus curiae* in such litigation. Its views would certainly be entitled to consideration. Is not a national court apt to provide a more sympathetic attitude in considering the delicacies of international relations, than many state courts?

Another practical reason in support of a uniform federal rule is that there might be somewhat greater certainty involved in the application of conflict of laws principles if the Federal courts, under the guidance of the Supreme Court of the United States, were able to establish the rule. Even as prosaic and black-letter an authority as American Jurisprudence has remarked as follows on the state of the law with respect to choice of law rules on the interpretation of contracts in the courts of the several states:

It is apparent from an examination of the rules and authorities cited in the three following sections that there is more confusion in this field of conflict of laws than in any other. Even upon a casual inspection of the authorities, the reader is met with the apparently illogical situation that all three rules—the place of making, the place of performance, and the place of intent—are cited as the controlling principle. Very generally, and often in a particular jurisdiction, any one or two and even all three of these principles have been laid down in different cases, and occasionally, even in the same case As a rule no effort has been made to distinguish between the problems and either one rule or another has been generally quoted and applied in a very desultory and irresponsible fashion.²⁰

While the same comment could be applied to decisions of the Federal courts until fairly recently, some order now seems to be emerging from the chaos. Chief Judge Magruder evinced the trend by his explanation in a 1950 admiralty case in which the question was choice of law in the interpretation of a contract:

But at least where the contract contains no explicit provision that it is to be governed by some particular law, what the courts

force to the question of whether there should be a "Federal Common Law" not just in *choice of law*, but also in all substantive legal questions, when a foreign national is involved; but I will not explore these broader implications here.

²⁰ 11 Am. Jur. *Conflict of Laws* §116.

applying this intention test actually seem to do is to examine all the points of contact which the transaction has with the two or more jurisdictions involved with a view to determining the 'center of gravity' of the contract, or of that aspect of the contract immediately before the court; and when they have identified the jurisdiction with which the matter at hand is predominantly or most intimately concerned, they conclude that this is the proper law of the contract which the parties presumably had in view at the time of contracting . . . In the infinite variety of circumstances presenting choice of law problems relating to contracts, it is safe to say that there is no simple and dependable rule of thumb by which the choice may be unerringly made.²¹

And in 1946 the Supreme Court, speaking through Mr. Justice Black, had suggested a similar test for choosing the law to be applied in the interpretation of a contract:

But obligations, such as the one here for interest, often have significant contacts in many states, so that the question of which particular state's law should measure the obligation seldom lends itself to simple solution. In determining which contact is the most significant in a particular transaction, courts can seldom find a complete solution in the mechanical formulae of the conflicts of law. Determination requires the exercise of an informed judgment in the balancing of all the interests of the states with the most significant contacts in order to best accommodate the equities among the parties to the policies of those states.²²

Thus the "center of gravity" or "sum of the contacts" rule appears to be becoming prevalent in the Federal courts. It is impossible to make anything of the confusion in the views expressed by the state courts and, from personal experience, the writer can testify to the scorn with which foreign nationals view the total lack of certainty available in American law on what appears to be a rather simple issue.

CONCLUSION

I repeat that this is not intended as a scholarly discussion and that there is no attempt to be either exhaustive or balanced. It is a suggestion that the rule for which this brief outline has been prepared is one which is best from a policy standpoint and has firm theoretical bases which could support it. There is nothing to prevent the Supreme Court of the United States from adopting the suggestion which is hereby commended to it.

²¹ *Jansson v. Swedish American Line*, 185 F.2d 212, 218-219 (1st Cir. 1950).

²² *Vanston Bondholders Protective Committee v. Green*, *supra* note 8 at 161-162.